

Realty Stock Review

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Mortgage Finance: Rising Nonearning Assets Squeeze Margins.

Lower Rates Should Help But Investor Caution is Advised

Falling interest rates, the supposed tonic for mortgage lenders, are having perverse effects in the Mortgage REIT & Finance group. Only residential mortgage lenders, Countrywide Credit Industries (see p. 4) and Fannie Mae (see p. 5) have benefitted in market perception that increased activity in refinancing lies ahead. And while profits from that business has yet to fall to the bottom line, the stocks have risen in anticipation.

For mortgage lenders, the story is the reverse. Falling interest rates theoretically should widen their net spread on borrowed funds, yet our latest readings suggest that a strong rise in nonearning assets is actually reducing the interest margin. The effect of nine years of skyrocketing debt formation has

been to severely crimp available cash flow for many of the users of debt capital limiting room for maneuvering. For the mortgage REIT's (those remaining after the scourge of the 1970's) this would spell big trouble as net interest margins are already falling to uncomfortable levels, result of a distressing rise in nonearning assets.

We find this an unnerving trend for mortgage REIT's, similar in many ways to the scenario before the collapse of the industry in the mid-1970's. Southmark Corp.'s July bankruptcy filing could be just the first act in a story of real estate concerns unable to service massive debt built in the 1980's.

Already on the ropes from the Mortgage Finance group are Integrated Resources (see p. 6) - embroiled in fighting off Ch. XI; Lomas Financial (see p. 7) which operates in the battered real estate markets

of the Southwest; and Wedgestone Financial (see p. 8), a northeast lender whose aggressive lending policy backfired.

Nonearning assets are on a secular increase for the group ranging from manageable 5.3% for BRT Realty Trust to an astounding 54% for Wedgestone Financial. Here's the change in non-performing assets vs. total assets for the latest six months reported by these mortgage lenders.

	9/88			3/89		
	Total Assets	Non-Perf. Amt.	%	Total Assets	Non-Perf. Amt.	%
BRT Realty	\$201.6	\$8.4	4.2%	\$197.0	\$10.2	5.3%
Cervill Inv.	196.1	0.0	0.0	202.7	25.3	12.5
Lomas & Net.Mtg	1,132.8	72.7	6.4	1,187.0	73.1	6.2
Mtg. & Realty Trust	486.5	21.0	4.3	496.2	28.5	5.7
Wedgestone Fin.	100.8	35.1	34.9	91.4	49.5	54.2
TOTAL	\$2,117.8	\$137.3	6.5%	\$2,174.3	\$186.6	8.6%

We aren't saying that all mortgage lending REIT's are in trouble. But we are suggesting that you will want to trade very cautiously with very close stop loss orders — in the 10% to 15% range. We will be suggesting specific stop loss points in our next Portfolio Selector.

Consumer mortgage lenders are quite another story. They should benefit from a mild swell in refinancings created from rate declines, which is now approaching the magic 2.5% to 3.0% peak to trough which makes refinancing feasible. And those that have diversified by

IN THIS ISSUE

GROUP REVIEW AND STOCK RANKING

Mortgage Finance Group Review	1
S&L Bailout's effect on realty stocks	2

STOCK RANKING REVIEWS

American Realty Trust	3
-----------------------------	---

BRT Realty Trust	3
Cervill Investors, Inc.	4
Countrywide Credit Industries, Inc.	4
Federal National Mortgage Association	5
Integrated Resources	6
Lomas Financial Corp.	7
Lomas & Nettleton Mortgage Investors	7
Wedgestone Financial	8

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making fee-based income a larger segment of earnings are poised to weather economic uncertainties.

With rates at their lowest point in over two years, many adjustable rate mortgage (ARM) and double digit fixed rate borrowers that missed the opportunity back in the spring of 1986 will seek to lock in lower rates. Some beneficiaries of this activity have been recognized by the market as Countrywide and Fannie Mae are trading at near highs for the year.

With this mixed picture, we are changing some Rankings. Lomas & Nettleton Mortgage (see p. 7) can't get out of the shackles of the depressed Oil Patch and we have lowered its Rank to C. Also lowered to C is BRT Realty, whose margins have been squeezed over the year but still remain over 5%. Wedgestone Financial is given an initial Rank of D.

We recommend extreme caution in approaching most members of this group today. Commercial and developmental lenders are at the mercy of slack demand. A recession could precipitate a crunch in this group that could have much graver implications for real estate values. Residential lenders are fully valued on latest reported earnings but conceivably could benefit if a recession induces more home refinancing.

S&L Bailout Should Have Minimal Impact on Realty Stock Investors

President Bush has signed the \$166 bil. thrift bail-out bill (approx. \$1000 per U.S. taxpayer). The funding is expected to span 10 years and take control of up to 425 S&L's in addition to the 262 insolvent thrifts already held. The new bill disbands the Federal Savings and Loan Insurance Corp. and replaces it with the Resolution Trust Corp. (RTC), a new federal agency under the direction of the Federal Deposit Insurance Corp. that will dispose of insolvent thrifts and their assets.

The S&L crisis has been predominantly focused in Texas and the Southwest, where the bulk of troubled S&L's are already under conservatorship. This geographic focus may spread a bit as thrifts scramble to increase their net tangible capital to 1.5% of assets, the new law's first requirement. An estimated 672 thrifts fall below this limit and it's expected many, if not most, will eventually be taken over by regulators.

The prognosis for the bailout's impact on the real estate industry is not rosy, but not all doom and gloom. The bulk of thrift assets are collateralized by residential property and land. Income properties are for the most part not of institutional quality and therefore don't

pose a major threat to the portfolios of large publicly traded real estate companies.

Regulators have tried to calm fears that they will "dump" \$150 bil. or more troubled real estate on the market, but the fact that the properties are held by regulators will likely put caps on local markets. Hardest hit will apparently be the housing industry and individual homeowners with a significant cap on real estate values occurring in some markets, mainly Texas and the Southwest. The wholesale disposition of real estate assets could stall impending recovery of real estate values, particularly in soft Southwestern markets.

All this means to us that the impact upon public real estate stocks will be minimal. Both the equity REITs and investment builders are not significantly exposed to the Southwest. Most homebuilders with exposure to the area — e.g., PHM Corp., Centex, U.S. Home, Emerald Homes L.P. — have already diversified their operations out of the area and shouldn't be impacted greatly. Mortgage lenders with exposure are reviewed this issue and most have already taken their lickings.

Could it get worse? Yes, but we doubt that there's a great probability of this happening for public companies.

Realty Stock Review

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AMERICAN REALTY TRUST (ARB: NYSE) RANK C

ARB is a mortgage REIT trying to disengage from the trauma surrounding Southmark Corp. (SM: NYSE—RSR July 14). ARB is now managed by SM's former top officers, Gene Phillips and William Friedman. ARB has just settled disputes over previous interrelated deals by swapping \$72 mil. mortgages and other assets for SM's 41.3% holding in ARB. The deal closed July 13, one day before SM's Ch. XI Bankruptcy Court filing. The deal increased Phillips' and Friedman's stake in ARB to 26.4% and should let ARB begin operating independently of Southmark — if ARB doesn't get ensnared in SM's bankruptcy. In this fluid situation, we are holding Rank at C for now.

Gut issue: Can ARB succeed on its own? We expect Messrs. Phillips and Friedman to try to build a major new public realty entity using ARB (along with National Realty — see RSR, July 14) as their bases. How successful they will be is really a guess at this point since ARB's ability to operate independently remains unproven. And while the recent deal should have separated the questionable assets generated by Southmark from ARB's other holdings, how remaining assets perform remains to be tested.

Asset values: Equity at Dec. 31, 1988 stood at \$6.38/sh. and the July loan swap took place valuing assets at book value. ARB emerges with \$88.5 mil. invested assets, mostly mortgages. Assets before the SM swap were 54% first mortgages, 37% second liens, and 9% third and fourth liens, the latter mostly wraparound mortgages. By location 20% are Texas and 14%

Nevada. Asset mix following the swap isn't spelled out. All loans are reported current. ARB's properties include a 331,000 sq.ft. St. Louis office building leased to Missouri Pacific and nine former Gino's restaurants in Calif. In view of St. Louis' soggy office market, we doubt there's much hidden value there.

Earnings and dividends: ARB earned \$0.42/sh. from operations in 1988, down 52%; EPS was after \$0.23 provision for loan losses. March qtr. results haven't been reported. ARB paid \$0.63/sh. in 1988, and in July raised payout to an indicated \$0.76 annual rate.

Advice: We can't see any compelling case to buy as-yet untested assets, and are holding ARB to C Rank for now. Speculative accounts may want to buy for above-average yield and hold as a play on Phillips/Friedman success. (KDC)

ARB:NYSE Rank C Dec. yrs. 21.73 mil. shs. (14.512 after July swap)
Price: \$4.25 Div. \$0.76 Yld. 17.9%

Year	Op.EPS	Div.	High	Low	Yld.Range
9/85	\$0.18a	\$0.00	\$8.25	\$6.25	0.0 - 0.0%
9/86	0.39a	2.50	9.75	6.13	NM - NM
12/87	0.88a	0.52b	8.25	3.25	16.0 - 6.3
1988	0.42a	0.59	5.13	3.88	15.2 - 11.5
1989E	NE	0.74	4.88	4.00z	

a-Bef.cap.gains: '85: \$1.01; '86: \$0.14; '87: \$1.08; '88: \$0.01. b-Annualized. z-To date. NM-Not meaningful. NE-No estimate.

Finances 12/88 (Mil.\$): Debt: \$36.9M; Equity: \$138.7M or 6.38/sh. Debt/equity ratio: 0.27-1.
Address: 15770 N. Dallas Pkwy., #1100, Dallas, TX 75248. (214) 233-0100.

BRT REALTY TRUST (BRT: NYSE) RANK C

BRT has evolved from a small combination REIT into a short-term, senior and junior mortgage lender secured by income producing properties located in NY, NJ, CT and PA. BRT is under the guidance of principals of Gould Investors L.P. and about 16% of shares are owned by the Gould family. Management is among the most competent and knowledgeable around but soggy Northeastern real estate markets compel us to lower Rank to C for now. We retain in Portfolio Selector with tight limit prices.

Gut Issue: Can BRT roll with the turndown in Northeastern property markets? So far BRT has avoided real damage from the downturn, which has inflicted severe damage to earnings for banks and S&Ls. BRT is not immune and operating EPS have fallen to \$0.56/sh. for both March and June qtrs., result of slightly lower funded assets and declining yield as interest rates fall. Interest expense hasn't fallen quite as rapidly and net interest spread on borrowed funds has dropped by about 1.5% the past year.

Under these circumstances we think you should expect the next dividend declaration, scheduled for Sept., to fall from the \$0.62/qtr. (\$2.48 annually) paid June 30. The stock market has already discounted a lower dividend, with BRT now trading in the 15-16 range vs. \$18-\$19 previously.

Market position: Known for its market expertise, BRT's forte is in making quick lending decisions. For its fast action, BRT gets returns 1/2% to 1-1/2% over comparable lenders and 3-5% over prime rate. BRT has a high degree of sophistication in the markets in which it operates, manifest under its chief lending requirement: that it be comfortable running the property itself. With nearly 95% of its investments in variable rate mortgages, BRT's returns fall along with general interest rates, which have come down by 1% or more since spring.

Invested assets of \$197 mil. at June 1989 are down 9.5% since peaking a year ago. Invested assets are 94.7% earning mortgages and 5.35% nonearning mortgages and foreclosed property. The mortgage mix reported most recently was 56% first mortgage loans, nearly all short-term; 44% junior mortgages, of which over half are secured by apartment projects; and 2% wraparound mortgages. Most loans secure properties in the New York metropolitan area, and are generally made as bridge or temporary financing for conversion or rehabilitation of apartments and more recently for office/retail financing. Terms are from 6 to 36 mon. BRT seeks to enhance yield by participating in gross revenues from conversion and selling participations in some loans.

Nonearning loans and foreclosed properties have been well controlled but are rising modestly, reaching 5.35% of invested assets at June 30. This level is not threatening but evokes concern.

Advice: Hold for aggressive income. We think BRT will ride out this dip in property markets, hence we wouldn't be a seller. But in view of the worrisome Northeastern property markets, we would not buy BRT right now except on big price dips, and then only for aggressive income accounts. (KDC)

BRT—NYSE RANK C Sept. years 7,360 mil. shares.
Price: \$16.00 Div. \$2.48 Yld. 15.5%

Year	Op. EPS	Div.	High	Low	Yld. Range
1985A	\$1.26	\$0.00	\$ 9.38	\$5.25	0.0- 0.0
1986A	1.75	0.40b	17.25	7.13	22.4- 9.4
1987A	2.33a	1.99	20.13	14.13	14.1- 9.9
1988A	2.53	2.43	19.38	14.50	16.8-12.5
1989E	2.25a	2.41	19.38	15.50z	

z-To date. a-Excl. cap. gains: '87 \$.07; '89 \$.08. b-\$1.60 annualized.

Finances 6/89 (Mil.\$): Debt: \$91.2M; Equity: \$106.3M or \$14.44/sh. Debt/Equity ratio: 0.8-1.
Address: 60 Cutter Mill Rd., Great Neck, N.Y. 11021. (516) 466-3100.

CENVILL INVESTORS INC. (CVI: NYSE) RANK C

CVI is a construction and development lender mainly for Southeast Fla. condo and apartment developments. About 21% of loans are to Cenvill Development (ASE), a related entity from which CVI was spun-off in 1981. CVI is increasingly lending in other parts of Fla., and for office and shopping center development. But a real estate slowdown is hurting EPS; dividends have been cut once and we expect another trim with the next declaration later this month. We will hold C Rank for now.

Gut Issue: Will CVI turn energy toward improving its property portfolio? Because it was spun off from a retirement community developer, CVI still owns a small but interesting group of income properties. Biggest is 164,000 sq.ft. Westward Shopping Center in West Palm Beach, where CVI is spending \$6 mil. to expand the center by 74,000 SF to 238,000 SF. As part of the expansion CVI bought out an old Kmart lease (which had been paying \$1.25/SF rent) and is releasing the space at \$12-\$18/SF. We think this deal alone will add about \$0.33/sh. to value. A smaller center in Deerfield is 95% leased. CVI also is spending \$1.5 mil. to renovate its 154-room motel in West Palm Beach, which will reopen in Oct.

Earnings and dividends. But CVI could give up some of those value gains in its mortgage lending. It has now put \$25.3 mil. loans on non-accrual and the lost income is hurting EPS. EPS fell to \$0.35/sh. in the June qtr., down 15% from the March qtr. and 30% below 1988. CVI paid a \$0.40/sh. dividend July 6 to record holders of May 26; in view of the disappointing June qtr. EPS, we'd not be surprised by further erosion to about \$0.35/qtr. rate. And we're not comfortable estimating EPS for 1989.

Troubled loans. Total loans outstanding have fallen about 9% from their peak and CVI has about \$41 mil. unfunded commitments, most to Cenvill Development. CVI's \$197.4 mil.

loans outstanding at Mar. 1989 were 59% (\$17 mil.) short-term construction and development loans; 27% long-term loans secured by recreational facilities in retirement communities; 9.5% GNMA pass-thru certificates; and 2.4% notes due from Cenvill Development. So far CVI has put \$25.3 mil. short-term loans on nonaccrual (21.6% of such loans) and in 1988 added \$2.7 mil. or \$0.40/sh. to its loss reserve to recognize the slowdown in condo sales.

Major loans on nonaccrual include \$14 mil. on high-priced condo Boca Grove Plantation in Boca Raton, and \$8.5 mil. on two quadplex projects in Delray Beach. In most troubled loans CVI gets sales proceeds as repayment when units are sold, then relends the money so the developer can complete the project.

Advice: Hold for speculative income; new buyers should avoid. CVI operates in the highly competitive south Florida realty development and condo market, where its managers have long operated successfully, and it has some very good long-term assets. But we can't predict when Fla. condos will recover enough to reduce the risk in CVI shares. Officers and directors of CVI hold about 25% of common shares. (KDC)

CVI—NYSE RANK C Dec. years 6.88 mil. shares.
Price: \$10.50 Div. \$1.60 Yield 15.2%

Year	Op. EPS	Div.	High	Low	Yld. Range
1985A	\$2.16a	\$2.35	\$23.00	\$15.38	15.3-10.2
1986A	2.07	2.00	20.00	15.63	12.8-10.0
1987A	2.20a	2.15	21.88	16.25	13.2- 9.8
1988A	1.83a	2.15	20.38	14.50	14.8-10.6
1989E	NE	1.75	16.38	10.00z	

a-Incl. amortized & current sale gains: '85 \$.04; '87 \$.10; '88 \$.21. z-To date. NE-No estimate.

Finances 3/89 (Mil.\$): Debt: \$99.8 mil. Equity: \$87.1 mil. or \$12.66/sh. Debt/Equity ratio: 1.15-1.
Address: Century VII. Admin. Bldg., N. Haverhill Rd., West Palm Beach, Fla. 33417. (407) 640-3155.

COUNTRYWIDE CREDIT INDUSTRIES, INC. (CCR: NYSE) RANK B

CCR has grown to become the nation's fourth largest mortgage banker and largest independent operator. CCR has demonstrated its ability to weather interest rate and related housing cycles. Having aggressively expanded its branch network in the early 1980's CCR still has great flexibility to

contract in down markets. By using a low overhead proprietary computerized processing system and fewer personnel, network fine tuning can be accomplished much faster than the industry norm. CCR sells its originations as mortgage backed security issues, some to a related CMO REIT, Countrywide Mortgage

Investments (CWM:NYSE).

CCR's ability to navigate weak markets is due to its cost advantage in originations and diversification into counter-cyclical operations including: a \$12 bil. servicing portfolio; a Calif. thrift; an insurance agency; securities and servicing brokerage operations; and fee income as advisor to CWM. Rank holds at B.

Gut Issue: Will CCR effectively pursue the expected wave of refinancings as interest rates keep falling? With interest rates on 30 year fixed rate mortgages falling to single-digit range, the lowest level in nearly two years, refinancing by adjustable-rate mortgage holders and others who missed the window of opportunity back in 1986 should take off as these individuals look to lock in lower rates. CCR's direct-mail marketing approach is effective for targeting this type of business which gives it an edge.

While originations in fiscal 1989 were off about 1% to the \$3.194 bil. level, vs. \$3.225 bil. in fiscal 1988 and May quarter (1Q) was down 30% from the previous year, CCR's servicing portfolio has grown over 40% to \$12.352 bil. during the period. If CCR maintains momentum, the servicing portfolio should grow another 23%. Diversification has helped CCR to cushion the shortfall in origination income and reduce earnings volatility. May earnings were down 25% to \$0.15 vs. \$0.20 in the first quarter of fiscal 1989. We expect Aug. earnings to be more in line with last year and earnings in the last two quarters to surpass fiscal 1989's for results similar to 1989 as originations make a comeback.

CCR's origination business has a unique cost advantage and flexibility, which should give it an edge over competitors in the leaner volume times ahead. By using a proprietary computer system linking all offices, CCR originates (markets) loans for about 0.8% (80 basis points) of principal vs. the 150-200 basis

points industry average (basically commissions). CCR's processing system allows for greater flexibility (lower cost) in the expansion or contraction of its branch network to meet current market conditions, as branches employ two-to-four salaried employees rather than a network of salesmen. CCR's edge is already recognized. Management owns 24% of CCR and the Canadian-based Belzberg family, a widely known takeover group, lead a group with a 7.6% stake.

In addition to the servicing portfolio, other lines have shown substantial growth over the 12-months ended May 31, 1989. Thrift assets have grown 175% to \$150 mil. Insurance premium volume increased 20% to \$7.2 mil. Securities trading volume grew by 115% to 1.066 bil. Servicing brokerage (new operation) volume was \$513 mil. And CWM management fees climbed 44% to \$427,000. This will help CCR achieve a more stable earnings stream in the future. Book value has grown to \$6.59 per share from \$6.48 per share at fiscal year-end.

Advice: Buy for long-term but don't chase past \$11. Alternative income sources reduce CCR's earnings volatility. With refinancings fueling the industry for the near future, CCR should see recovery in its origination activity to levels similar to fiscal 1989. If the economy is truly in for a "soft landing" CCR's ability to expand fast is a big plus. (MJH)

CCR—NYSE RANK B Feb. years 16.7 mil. shares.
Price: \$9.88 Div. \$0.28 Yld. 4.6%

Yr.	OpEPS	Div.	High	Low	Yield
1986A	\$0.43	\$0.14	\$ 7.38	\$4.88	1.8-2.7
1987A	1.06	0.25	14.75	7.13	1.6-3.2
1988A	0.77	0.26	16.88	4.63	1.6-5.8
1989A	0.74	0.28	9.25	5.13	3.2-5.8
1990E	0.75	0.28	10.25	6.25z	

z-To date.

Finances: Long-term debt: \$20.9 mil. Equity \$110 mil. or \$6.48/sh. Debt/equity ratio: 0.19-1.
Address: 155 North Lake Ave., P.O. Box 7137, Pasadena, CA 91109. (818) 304-8400.

FEDERAL NATIONAL MTG. ASSN. (FNM: NYSE) RANK A

FNM, the Federally chartered but stockholder owned company that provides liquidity to the national secondary mortgage market, has made a spectacular recovery from the dark high-interest days of the early 1980s. It has been among the best performing stocks, giving investors a 117.9% total return in the last 12 months. And all this without any hint of takeover.

The spark behind FNM's spectacular rise is the big move toward lower interest rates. Since FNM is far and away the most highly leveraged company around (debt is about 41 times equity), lower rates literally coin money for FNM. But FNM's status as the premier interest rate play masks some very fundamental structural changes FNM has made in recent years to moderate the risk that FNM's EPS is a mere creature of the ups and downs of interest rates. When FNM stock is on a tear, as it currently is, it always looks expensive to us. So it's best approached with a trading or long-term thought in mind. We retain our A Rank.

Gut Issue: Would any hint of higher interest rates choke FNM's bull move? As analysts we can recognize the benefits of FNM's massive restructuring in recent years. But generations of stock traders and investors have looked on FNM as their No. 1 interest rate play. Hence our worry about higher rates.

Could the rate decline abort? The consensus that even lower rates are ahead is now so strongly ingrained in Wall Street that it's hard to believe that six months ago everybody was worrying that rates would go to the moon as the Federal Reserve tried to halt inflation. All this suggests that FNM stock still dances to the Fed's tune, and that new investors should keep their ears to the ground when Fed Chairman Greenspan talks.

Structurally, FNM insists that the days are gone when its earnings reflected the money market's short-term fever chart. FNM Chrm. David Maxwell is so confident of FNM's new insu-

lation against money market tides that he predicted in Feb. a new 1989 EPS record under "reasonably foreseeable events". His prediction now looks hopelessly conservative. We now figure that FNM could earn \$8.25-\$8.50 for 1989, up \$1 from our previous estimates. Longer-term, FNM now has four profit components that should stand it in good stead if and when interest rates turn:

Portfolio growth: FNM buys mortgages from local originators and holds most of them. FNM's portfolio declined 3% to \$100.2 from \$103 bil. at year-end 1988, about in line with its historic 6% growth rate. FNM in recent years has tried to boost portfolio yield by increasing holdings of adjustable rate mortgages (ARMs), now at 21%, and shortening portfolio maturity (about 20-25% of loans mature in less than 20 years). This has boosted overall portfolio yield to 9.98%.

Rising spread: FNM finances mortgage purchases by selling "agency status" securities. So far in 1989 FNM widened its net spread on mortgages by 0.14% to 0.71% by rolling over high-cost debt from the early 1980s with current cost debt. This widening spread has helped fuel EPS. But this high leverage (non-convertible debt is 20 times capital) makes FNM a barometer of money market trends.

Higher MBS fees: FNM has become a major issuer and guarantor of mortgage backed securities (MBS), earning fees that

largely fall to the bottom line. It issued \$26.9 bil. MBS in the June qtr. and has \$196.5 bil. MBS outstanding. MBS fee income rose 25% to \$98.8 mil. in the quarter, and should come close to \$400 mil. this year.

Credit losses up: Losses in 1989 are up significantly over Dec. 30, 1989 levels. We had expected loan loss provisions to fall from present high levels. FNM provided \$427 mil. in 1989 for loan losses, or about \$5.37/sh. pretax. But realized losses should fall as tighter underwriting standards effected in 1985 take hold and rates moderate. Sooner or later, EPS will benefit.

Advice: Buy these volatile shares on any big dips to the mid-90s (about 11 times our higher 1989 estimate) and hold long-term. (KDC)

FNM—NYSE Rank A Dec. yrs. 79.48 mil. shs.
Price: \$96.25 Div. \$1.28 Yld. 1.3%

Year	Op.	EPS(Dil.)	Div.	High	Low	P/E Range
1985	(0.10)	0.16	\$29.63	14.00	NA	
1986	1.42	0.20	42.00	22.75	29.6-16.0	
1987	4.63	0.36	48.38	25.00	10.4-5.4	
1988	6.32	0.72	52.63	29.00	8.3-4.6	
1989E	8.25	1.20	100.63	50.13z		
z-To date.						

Finances 8/89 (Bil. \$): Debt: \$103.8 bil.; Capital: equity: \$2.43 bil. Plus \$2.5 bil. debentures; Capital ratio: 21-1. Equity/sh.: \$30.57.

Address: 3900 Wisconsin Ave. N.W., Washington, D.C. 20016. (202) 752-7115.

INTEGRATED RESOURCES INC. (IRE: NYSE) RANK D

Once king of tax-shelter syndicators, IRE has been engulfed by debt disaster and a Chapter XI bankruptcy filing cannot be ruled out. We advised either selling or avoiding when we reviewed IRE in Feb. 1989, citing multiple uncertainties. Those warnings turned ugly when IRE was unable to roll over commercial paper on June 9, and subsequently defaulted on \$955 mil. short-term debt. We have reduced Rank to D.

Gut issue: Can IRE avoid bankruptcy? IRE is now engaged in talks with its multiple layers of creditors holding \$1.8 bil. of IRE paper and its chairmanship has been taken over by a senior officer of Drexel Burnham Lambert, the junk bond king which raised much of IRE's money as its investment banker over the years.

Drexel has proposed restructuring IRE in a proposal to sell \$300 mil. new first mortgage bonds (with Drexel itself buying \$100 mil.). The money would go to holders of \$840 mil. short-term paper, giving them about 30 to 35-cents per dollar. Their remaining claims would be converted into four-year, 10% first mortgage notes. Holders of IRE's junior bonds and preferred would be asked to take large amounts of new common, and it's expected that IRE will double or triple common shares outstanding to about 15 to 23 mil. shares.

Perishable asset. Most investors agree that IRE's principal asset is its 4,500 person sales force. But that sales force is organized as a series of independent salesmen who operate under the umbrella of IRE's securities brokerage. Those independent

salesmen live and die on commissions from new product, and IRE isn't generating any new product right now. Unless IRE gets its financial troubles settled soon, that sales force could drift away, eroding IRE's value.

We've worried for years that IRE consistently ran with negative cash flow. IRE always argued that it needed front-end cash to inventory properties and mount sales efforts for its tax shelter and annuity programs. Positive cash flow would indicate no-growth and decline, IRE said. If that's true, then there's real doubt that creditors will sign on to any plan that continues IRE's negative cash flow ad infinitum. The world of tax-shelter sales has changed dramatically in recent years and IRE's rescue may require more than just a shuffling of paper.

Advice: Avoid or sell. Only seasoned arbitrageurs will try to trade IRE bonds and maybe the preferred. This is not a cup of tea for most investors and we'd pass for now. (KDC)

IRE—NYSE Rank D Dec. yrs. 7.42 mil. shs.
Price: \$3.25 Div.: None Yld.: None

Year	Op.	EPS(Dil.)	Div.	High	Low	P/E Range
1985	\$3.17a	0.00	\$26.38-13.75	8.3-4.3		
1986	1.06a	0.00	40.25-16.25	38.0-15.3		
1987	2.98a	0.00	32.88-14.75	11.0-4.9		
1988	2.76a	0.00	23.75-11.75	8.6-4.3		
1989E	NE	None	18.00-1.75z			

a-Before losses on extra items: '85 \$1.13; '86 \$2.79; '87 \$0.25; '88 \$0.34. NE-No estimate.

Finances 3/89 (Mil. \$): Debt: \$1,546.6; Pfd.: \$350.7; Common: \$139.64 ind. \$82 intangibles. Tangible book value: \$7.77/sh.

Address: 10 Union Sq. East, New York, N.Y. 10003. (212) 353-7000.

LOMAS FINANCIAL CORP. (LFC: NYSE) RANK C

LFC, once billed as an emerging financial services giant, has exited single-family mortgage origination (altho LFC still services over \$20 bil. mortgages) and is shedding profitable bank credit card and leasing operations to reduce debt. Dallas based LFC hopes this sets the stage for resumed profits. LFC lost \$282 mil., including \$261.2 mil. non-recurring reserves related to restructuring and \$15.7 mil. extraordinary credit, in its June 1989 fiscal year but hopes to be profitable in FY 1990. The dividend was eliminated earlier this month. We are holding LFC at C Rank for now and continue it in Portfolio Selector as a wait-and-see recovery candidate.

Gut issue: How certain is LFC's recovery and how steep is the road back? When LFC lost \$1.85/sh. in FY 1988, most investors familiar with its excellent long-term growth record felt comfortable with expecting a fairly rapid recovery. Now that LFC lost \$8.23/sh. for 1989, doubters abound.

In view of its recent woes and the tar-baby nature of Texas' real estate recession, we can see only modest profits for 1990. The key to an LFC turnaround is its ability to reduce debt quickly. LFC has agreed to sell its retail banking unit, scheduled to close later this month, and closing is expected to cut debt to \$3.8 bil. from \$5.6 bil. at March 1989. LFC hopes to trim an additional \$1.8 bil. by selling its commercial leasing division and freeing bank lines by phasing out single-family loan origination. LFC hopes to find a buyer for the leasing unit by Dec., which would slice debt to \$2 bil. by that date.

But until these events occur, LFC will be lugging a very heavy debt load. By adding \$253 mil. to reserves in the June qtr., LFC effectively set up a place to charge some of these carrying costs. For example, it set aside \$100 mil. to carry its Texas real estate developments for three years, thru 1992. "Protective" reserves of \$70 mil. were set aside to cover costs of exiting mortgage origination and other real estate. In other words, LFC

seems to have set up a healthy cushion against future profit erosion.

But the Texas recession has hung on far longer than anyone expected and many investors who put money into Texas companies and projects in 1986 and 1987 figuring the worst was over are licking their wounds. Virtually all the large Texas banks and savings & loans have been taken over by out-of-town financial institutions or regulators. This means the Texas property and mortgage markets have far less liquidity for maneuvering than they had in the mid-1970s. All this signals caution for us.

LFC emerges from its trauma with a much less diversified earnings base, with commercial mortgage banking and servicing, life insurance, short-term lending, and realty development left for a rebound. And since the reserve allocations tell us that short-term lending (mostly for real estate) and direct development won't be big profit producers for some time, LFC has a relatively small base to work with.

Advice: Long-term investors will continue to hold, but we think new purchasers should wait till the smoke clears. We have high regard for LFC but the recession seems to be well beyond the ability to predict comfortably. (KDC)

LFC—NYSE Rank C June years 29.97 mil. shs.
Price: \$7.88 Div.: None Yld.: None

Year	EPS dil.	Div.	High	Low	P/E Range
1986	\$1.83	\$0.97	\$35.33	20.67	19.3-11.3
1987	1.45	1.26	39.25	23.25	27.1-16.0
1988	d1.85a	1.40	34.50	15.00	d
1989	d8.23a	1.23	20.38	8.00	d
1990	NE		9.50	6.88z	

a-Before extraordinary credit: '88 \$2.0; '89 \$4.2. z-To date. NE-No estimate. d-deficit.

Finances 3/89: Debt: \$5.6 bil.; Equity: Pfd: \$294 mil.; common: \$223.7 mil. (\$7.47/sh.) incl. \$915 mil. in tangibles; Debt/equity ratio: 11-1.

Address: 2001 Bryan Tower, P.O. Box 655644, Dallas, TX 75265 (214) 746-7111.

LOMAS & NETTLETON MTG. INVESTORS (LOM: NYSE) RANK C

LOM is the oldest pure short-term mortgage REIT, managed by Lomas Financial Corp. One of the largest REIT's, LOM has \$1.187 bil. of invested assets. LOM has compiled an excellent record of maintaining dividends and liquidity.

Loans average 15 mon. terms and are about 70% construction first mortgages, 23% acquisition/development firsts, and the rest other loans. The bulk of loans are in California followed by Colorado, Washington and Texas. LOM's current EPS and payout are being squeezed by the insidious degradation of its loan portfolio while its cost of funds increases. We are reducing Rank to C.

Gut issue: Will LOM's \$27 mil. addition to loss reserves signal an end to the erosion of its portfolio? At the close of fiscal 1989 (June 30) LOM established special reserves to cover an anticipated deluge of bad loans. LOM was confident enough in its provision to declare a \$0.50 dividend for the June quarter.

LOM did the same thing in 1974 and got away with it. LOM wrote down approx. \$25 mil. and continued paying its dividend. Ultimately LOM did not have to use most of the reserve and the dividend held. If history is going to repeat itself is yet to be determined.

MTG REITS/FIN 8/1/89

What concerns us is the rapid deterioration of LOM's net interest margin. At Mar. 30, net interest stood at 2.13%, down from 2.70% in the Dec. quarter. The contrast is more striking if compared to LOM's Mar. 30, 1988 net interest spread of 3.42%

LOM's interest expense at Mar. 30 was 10.53%, up from 9.72 a quarter earlier. With a reduced base of earning loans to cover borrowing costs, cash and hence dividends come under increasing pressure. LOM has about reached the limits of safe leverage.

With about 75%-80% of loans tied to the prime rate, LOM should feel some pressure as prime has fallen about a point from the 11.5% level of spring. The run up of rates in the commercial paper market which also squeezed margins has not yet eased as short-term rates are still nearly par with longer-term rates.

LOM's \$896 mil. debt is 3.57 times \$251 mil. eroding shareholders' equity. This is the level of leverage experienced by short-term construction/development lending REITs during the mid-1970s. Higher leverage ratios tend to produce more interest rate risk than the very small increment to earnings.

With the loss reserve provision, LOM experienced a loss of \$17 mil. or \$1.48 per share for the June qtr. For the year EPS amounted to \$0.28. Earnings in 1990 should rebound to the

\$2.00/sh. level, with payout corresponding. Non-earning investments rose to \$73.1 mil. or 6.5% of investments at 3/89, from 6.09% in the Dec. quarter.

Once highly concentrated in Texas, LOM had up to now escaped troubles there by diversifying loan holdings into other states. California now accounts for about 28% of outstanding loans, with Texas in fourth place.

Advice: Avoid shares. With interest rates moderating, defaults should fall and origination and refinancing activity increase. However until earnings stabilize and LOM restores margins we feel risks outweigh possibility of turnaround. (MJH)

LOM—NYSE Rank C June yrs. 11.70 mil. shs.

Price: \$15.50 Div.: \$2.40 rate Yld: 13.4%

	EPS dil.	Div.	High	Low	Yld. Range
1985	\$2.49a	\$2.45	\$28.63	\$16.88	14.5-8.6%
1986	2.61a	2.69	34.00	24.00	11.2-7.9
1987	2.42a	2.49	32.38	22.13	11.3-7.7
1988	2.54a	2.54	23.75	16.25	15.6-10.7
1989	0.28a	2.40	23.38	15.25	15.7-10.3
1990E	2.00	2.00	19.38	15.50z	

a-Fully diluted. z-To date.

Finances: Debt: \$897.0 mil.; equity: \$251.0 mil. or \$21.45/sh. Debt/equity ratio: 3.57-1.

Address: 2001 Bryan Tower, P.O. Box 655644, Dallas, TX 75265. (214) 746-7111.

WEDGESTONE FINANCIAL (WDG: NYSE) RANK D

An aggressive Boston-based short-term lender, WDG has encountered a high level of problem loans. The dividend has been omitted and WDG has agreed to stop making new mortgage loans until loan repayments and recoveries let it prepay \$30 mil. fixed-rate debt. We estimate that WDG may need two to three years to make the lenders happy and this takes all the interest out of WDG for a long time. Thus we are posting a D Rank for the shares.

Gut Issue: How long will it take WDG to turn its portfolio around and shed festering problem properties? This central question has dogged WDG for a year. In Sept. 1988, we thought WDG might make a rapid recovery because its staff is truly gifted and geared for turnarounds. Now it appears that WDG's problems are being exacerbated by widening real estate softness in New England and holders may sit some time without a dividend.

WDG is known as an aggressive lender of last resort: Loans were priced at 6% over prime and 6% commitment fee; with such rates, WDG wanted only borrowers who'd been turned down elsewhere but had a compelling need for quick funds to close a

real estate deal. The formula produced high profits for a time but now a backup of bum loans is sitting in nonearning status.

Now problem assets have soared: 54% of \$91.4 mil. investments were nonearning loans or foreclosures at Mar. 31, and another 9.0% were partially earning loans. Frankly we haven't seen nonearning percentages of this size since the mortgage REIT flameout of the mid-1970s.

Advice: Avoid for now. Only Houdini could conjure up a quick escape for WDG. Until life signs reappear, no reason to wait around. (KDC)

WDG—NYSE Rank: D Dec. yrs. 5.80 mil. shs.

Price: \$1.75 Div.: None Yld. None

Yr.	Op. EPS	Div.	High	Low	Yld. Range
1985	\$1.35	\$1.19	\$10.00	\$7.38	16.1-11.9
1986	1.78	1.54	17.13	9.25	16.6-9.0
1987	1.79	1.79	17.25	10.50	17.0-10.4
1988	d1.92	1.15	14.13	2.25	NM-NM
1989E	d	None	3.75	1.50z	

z-To date. NM-Not meaningful.

Finances 3/89 (Mil.\$): Debt: \$44.5; Equity: \$35.6 mil. or \$6.15/sh. Debt/equity ratio: 1.25-1.

Address: 181 Wells Ave., Newton, Mass. 02159. (617) 965-8330.